

FILE

Central Intelligence Agency



Washington, D.C. 20505

DATE 11/14/86 FILEDOC NO GI M 86-20146OIR 3P & PD 1

DIRECTORATE OF INTELLIGENCE

11 July 1986

Trade Policy Formulation in Selected Developing Countries: Underlying Influences

Summary

According to results from an exhaustive study [redacted] 25X1 fundamental economic, social, and political conditions in developing countries exercise considerable influence on the shape of these countries' international trade policies. Overall economic policy, geographic factors, ethnic and class structure, and the political and governmental systems can, in many situations, be more significant than the roles of individual officials or ministries directly involved in the policy process. Large, populous countries such as Brazil and Indonesia, for example, tend to be more inward looking and protectionist than small countries like Singapore, while all LDCs' trade policy is colored by the centrality of economic development to their policies. In most of the LDCs examined, the chemistry of trade policy is changing, with increased market orientations, a greater role for technocrats, and political liberalization. This probably will increase the ability of the United States to further its trade objectives, although political liberalization could give more power to inward-looking groups in some instances. The body of this paper outlines some of the general determinants of LDC trade policy formulation, and the annexes to this typescript examine trade policy formulation in seven focus countries: Brazil, Indonesia, Malaysia, the Philippines, Singapore, South Korea, and Taiwan. [redacted]

25X1

25X1

This memorandum is derived from work [redacted] 25X1 sponsored by the Office of Global Issues. Comments may be directed to the International Trade Branch [redacted]

25X1

25X1

GI M 86-20146

25X1

CONFIDENTIAL

Trade Policy Formulation in Selected Developing Countries: Underlying Influences

Overview

As a new GATT multilateral trade round approaches, the importance of the developing countries (LDCs) to the round's success is already clear. Since the Tokyo round began in 1973, LDCs have become larger and more diverse exporters and more important markets. Many more private and governmental ties now exist between these countries and the United States, and interdependence is a reality. Closer ties have also brought an increase in bilateral trade disagreements, ranging from machine tools to services.

25X1

Our examination of trade policy formulation in selected LDCs, a focused look at seven major LDC traders -- Brazil, Indonesia, Malaysia, the Philippines, Singapore, South Korea, and Taiwan -- suggests that although there may be much policy variation among LDCs, their trade policies are driven to a great extent by basic economic, social, and political forces. No matter who is in power as commerce, finance, or even prime minister, these pressures will often lead to similar trade stances.

- o All focus on economic development as a central national goal. As such, trade policies are subordinate to and a part of developmental programs.
- o The size of a country is important. Generally, a country with extensive resources -- Brazil or Indonesia -- and a large domestic market has trade policies that are more internally focused than a smaller country with few resources, such as Taiwan or South Korea.

GI M 86-20146

- o In countries with internal security concerns caused by ethnic or class divisions (Brazil, Indonesia, Malaysia, the Philippines, and Singapore), economic and trade policy tends to be inward looking and is used to attain social goals by distributing wealth. South Korea and Taiwan, which are homogeneous states, have economic and trade policies that are far less inwardly focused.
- o In most LDCs, decisions tend to be pushed upward in the bureaucratic hierarchy. Cabinet members often have much greater individual power than is common in Western democracies. Policy formulation and implementation are usually closed and opaque.
- o The background of the leadership group plays a major role. Typically the first generation of post-colonial leadership focused on the task of nation-building. The second generation is emphasizing the creation of national wealth, and has given governments a technocratic cast. Today technocrats are, in some cases, being challenged by a third generation which is calling for increased popular participation in decision making. [redacted]

25X1

These strong political, economic and social influences on trade policy suggest that LDCs are not going to be easily induced to alter most of their trade policies. Indeed, they will probably only do so when convinced that such a move will further basic goals or respond to these basic political, economic, and social pressures. [redacted]

25X1

CONFIDENTIAL

Economic Opportunities and Constraints

Economic and trade policies may or may not take advantage of a country's endowments, but they are conditioned by them. A country's size, resource base, and level of development dictate to a great extent the opportunities and constraints policy makers face in trying to achieve national economic goals. The structure of domestic production, the size and organization of firms, the economic role of government, and patterns of domestic and international finance all influence a country's trade, its foreign exchange earnings, and the constituency for or against certain trade policies. Moreover, constraints and opportunities created by changing world conditions strongly affect the range of policy options.

25X1

Structural Characteristics and Trade Orientation

Generally, a country's degree of openness -- international trade focus-- is inversely related to its size. A country with extensive resources and a large domestic market is almost always more internally focused than a country with fewer resources and a smaller domestic market. Since a large country tends to be less import dependent, it faces less pressure to be a highly competitive exporter. Large countries also find it more difficult to resist narrow domestic political interests, since it is easier to spread the costs of protection among a larger population. A large country has long internal lines of transportation and communication that insulate its producers. Moreover, local production can achieve economies of large-scale operation in a wider range of products.

25X1

The most inward-focused of the group, in terms of trade share of GDP, is Brazil; it also is the most protectionist. Similarly, petroleum resources give Indonesia large export earnings and import capacity, but it too has

relatively little foreign trade for its size and natural resources. In Indonesia, as well as the Philippines, the natural resource endowment has been as much an excuse and prop for ill-designed policies as it has been a basis for economic development. At the other extreme, Singapore is the smallest and the most outward looking. South Korea, Taiwan, and Singapore have no or few natural resources, and consequently have had to rely on the development of human capital and the stimulation of human energies. In the other four countries, natural resources have been the dominant source of export and government revenues. Their economic development has been less rapid. The role of government and its policy reactions to economic change also help explain these differences.

25X1

Economic Policy

The focus countries all treat economic development as a central national objective, and since the 1960's have explicitly linked economic development to national security. There is widespread support for government intervention even in economies that are broadly directed by market forces. Because economic progress has become an aspect of these governments' legitimacy, the need for strong government intervention in the economy is used to justify relatively authoritarian political systems.

25X1

Focus country governments have, to varying degrees, followed policies that distort price structure and other incentives, although not on the scale of many other LDCs. The economies with the least price distortion tend to be those which are least protected from world market forces, and whose governments are quickest to adjust internal policies to changes in the external economic situation. For example, the 1974 and 1979 oil shocks, the subsequent recession and decline in primary product prices, and the sharp

increase in real interest rates prompted major policy adjustments, especially in Singapore, South Korea, and Taiwan. [redacted]

25X1

The focus countries have tended to use more market-oriented policies in general, and have maintained less distorted incentive structures -- between capital and labor prices, between production for export and for the domestic market, among investment categories, or among broad industry areas. The debate that has focused on export promotion versus import substitution policies has neglected to notice the fundamental market orientation of LDCs like these where government policy has been market supporting and even market guiding. In these countries the government role has included active export promotion as well as policies that support "appropriate" exchange rates and moderate inflation. [redacted]

25X1

### Social Structure

Economic and trade policy decisions are often affected by the need to control domestic forces. In countries plagued by severe ethnic, religious, and/or regional divisions the political leadership has had to concentrate on creating a national identity. Indeed, managing conflicting domestic interests is the predominant national security concern of most of the focus countries.

25X1

The greater the perceived threat of internal divisions the stronger is the tendency to interpret all policy in terms of its distributional impacts. [redacted]

Brazil, Indonesia, Malaysia, the Philippines, and Singapore have serious social divisions; in turn, each has focused on maintaining internal security. Indonesia and Malaysia are still in the nation-building process, while Singapore has succeeded. Brazil and the Philippines, however, are divided largely along social class and income lines, and have concentrated on preserving elitist political and social structures. In contrast, South Korea

and Taiwan are largely free of major internal social divisions. Ethnically homogeneous, they lack major regional, religious, and cultural divisions. They also face a serious external security threat. The ethnic homogeneity of these two societies, the external threats, and their neo-Confucian cultures have combined to create a strong domestic political consensus behind the government's policies. Historical events -- Japanese occupation, World War II, the Chinese revolution, or the Korean War -- have served to enhance this consensus by further strengthening national identity and solidarity.  25X1

Other countries with similar social structures and equivalent external threat, but without Taiwan and Korea's ideological commitment to economic development, would not necessarily adopt similar market-based, outward-oriented policies. The combination of forces at work in Taiwan and Korea were unusually strong in supporting the policies that were followed. Efforts by other LDCs to reproduce South Korean and Taiwanese successes are clearly at risk if there is no broad-based social commitment.  25X1

### The Political Process

Trade policy formulation also reflects the characteristic national in leadership, but in countries with a regularized succession process--or at least a strongly institutionalized political system, such as Brazil--style tends to be continuous. In this context, one trend of relevance to all of the focus countries has been the rise of a generation of leaders which is more technocratic in orientation and much less burdened by post-colonial political ideology than its predecessors. Typically, the first generation of post-colonial leadership -- for example, Sukarno in Indonesia or Rhee in South Korea -- focused on the task of nation-building, primarily emphasizing political values and nationalist ideology in an attempt to create national

solidarity and identity . The second generation has emphasized economic development and the creation of national wealth which has given an increasingly technocratic cast to the government. Both approaches have, however, supported the maintenance of authoritarian regimes which limit the degree of autonomous political participation. Today, these technocrats are, in some cases, beginning to be challenged by a third generation of leaders which is calling for increased popular participation in the decisionmaking process and political liberalization. [redacted]

25X1

The personalistic governing styles in these relatively authoritarian systems result in considerable power being given to some executive appointees. In all of the focus countries, some cabinet members have much greater individual power than is characteristic of most Western democracies. In some countries, Indonesia and the Philippines, for example, ministers or their equivalents are carefully selected to offset other ministers' power bases and to prevent them from becoming possible challengers. However, in Brazil, appointees' roles are constrained by fairly clear institutional boundaries. Decisions on trade policy tend to be pushed upward in the bureaucratic hierarchy -- often to ministerial level, and not infrequently to the chief executive. Another characteristic is the broad scope that is generally reserved for executive discretion. Although a formal system of rules and institutional procedures exists and does constrain discretionary authority, the personalized approach to policy decisions has become part of the institutional process. [redacted]

25X1

The legislature does not play an effective lawmaking role in any of the focus countries. The move to a civilian government in Brazil has raised the importance of the legislature and it could evolve into an effective lawmaking body. Similarly, the new government in the Philippines could revise the

constitution in ways that return an important lawmaking role to the legislature. In the other countries the the legislatures have evolved from legitimizing rubber stamps to forums for debate, but they have no real influence on trade decisions. [redacted]

25X1

Even so, the increased importance of legislatures reflects a general trend towards a gradual political liberalization which results, in part, from the increase in economic welfare generated by successful development. Almost all of the focus countries have begun to experience popular pressure for increased participation in policy decisions. The most dramatic example is the toppling of the Marcos government. Brazil has replaced its military government with a civilian one in which a wide range of views are heard. South Korea has slowly opened its system, but to a much lesser extent than Brazil. Although there has been limited change in Taiwan and Singapore, both countries are showing signs of permitting greater democratic expression. In Malaysia, already more open due to its parliamentary organization, the government coalition is being forced to deal with a greater diversity of political pressures. Indonesia is the only country in the group that has not responded in some way to democratizing pressures. [redacted]

25X1

#### Governmental Interest Groups

Within these countries' governments, a variety of interest groups impinge on the trade policy process. Technocrats are a relatively new elite. In most of the focus countries, this group have still not emerged as a coherent, self-identified pressure group. Rather, they have acquired political power on the basis of their specific expertise, and exercise often considerable power only in policy-specific areas. Technocrats also serve legitimizing roles for

political decisions -- this has been particularly important in Indonesia and the Philippines. [redacted]

25X1

Singapore is unique in that technocrats run its government and technocratic approaches dominate political decisionmaking. In Taiwan, although a bureaucracy with strong technocratic training has emerged, it still operates as a classic Chinese bureaucracy in which high-level decisions are made on political or personal grounds. The technocrats are slowly being promoted to senior bureaucratic positions, however, and this is slowly changing the character of bureaucratic decisionmaking. [redacted]

25X1

In light of the political roles of technocrats among the focus countries, the general patterns of economic and trade decisionmaking can differ from overall political decisionmaking. For example, macroeconomic policy in Indonesia is typically more technocratic than overall governmental decisionmaking which remains heavily personalistic, reflecting the patrimonial character of the Suharto regime. [redacted]

25X1

With the growing importance of technocrats have come changes in traditional bureaucracies in some of the focus countries. The greater the policy role of technocrats, the more modern the bureaucracy's system of implementing policy is likely to be and the more likely it is that policy will be implemented in ways that correspond with the original policy initiative. This does not mean that the policies are necessarily transparent -- only that the system implements them in relatively consistent, rational ways. On the other hand, the more traditional the bureaucracy, the more likely are layers of fragmented and complex paperwork processes, inconsistent interpretations, arbitrary actions, and graft and corruption. [redacted]

25X1

Bureaucracies always interpret policy while implementing it, but the degree of discretion permitted varies greatly. In Korea, Taiwan, and to some

degree in Malaysia, law is written so generally, with bureaucratic discretion so wide, that implementation requires very broad interpretation, in some cases broad enough to change the intent of the policy. In Brazil, the Philippines, and to a lesser extent Indonesia, law is so complex and contains so many inconsistencies resulting from an accumulation of executive decrees over time that the bureaucracies have wide latitude in determining which rules are enforced. All of the bureaucracies initiate policy ideas and proposals that sometimes serve as the basis for debate and discussion at high political levels. Indeed, bureaucrats in most ministries view their role as including policy prescription. [redacted]

25X1

State-owned enterprises (SOEs) also are important players in the trade bureaucracies of all of the focus countries. Except in South Korea and Singapore, state-owned enterprises are typically headed by politically influential individuals. In Singapore and South Korea operating heads are watched over by boards of directors that include politically important individuals, but the SOEs themselves usually do not play a political role. In the other countries, individual SOEs wield significant political power because of their economic importance. Despite the authoritarian nature of all of the focus countries, the direct political role of the military is extensive only in Indonesia. Usually, the economic and trade biases of the military tend to reflect the consensus. [redacted]

25X1

#### Outside Interest Groups

Private business has much influence in all of the focus countries, but does not always play an independent political role. The ability of private business interests to form independent and politically significant organizations varies widely. Chambers of commerce and similar, more

~~CONFIDENTIAL~~

specialized business associations exist in all countries and, to one degree or another, these organizations attempt to coordinate mutual interests and thus influence policy. In general such influence is restricted to specific business regulation issues, and often is very limited even there. In Indonesia and Singapore, business interests have little influence as independent political groups. The Brazilian business community, however, has achieved moderate to high influence on political decisions through independent interest groups and participation of individuals in the decisionmaking process. Brazilian business groups tend to be dominated by firms with a strong domestic orientation and which are often dependent upon continuation of import substitution. [redacted]

25X1

There is also considerable difference among the focus countries in the influence of landed interests. Large holder landed interests (generally export oriented agriculture) are traditionally associated with anti-growth, status quo forces. They are usually among the most negatively affected by economic progress and the emergence of new industry-based elites and middle-class urban interests. Landed interests frequently support more outward looking trade policies out of their interest in purchasing manufactured goods as cheaply as possible in return for agricultural export sales. Landed interests ceased to be a force very early in Korea and Taiwan even though rural interests (rural workers, tenant farmers, and small landholders) remain important. In the other countries, except Singapore, landed interests have retained some influence. [redacted]

25X1

In all of the focus countries multinational corporations have a substantial economic role but rarely have significant political influence. All of the countries, with the exception of Singapore, impose substantial limitations on the activities of multinationals. In Malaysia, Indonesia,

~~CONFIDENTIAL~~

Brazil and the Philippines the role of foreign investment is controversial. Multinational corporations remain a symbol of colonialism and imperialism and are a continuing political issue deeply tied to nationalism and pride. [redacted]

Multilateral financial institutions have had highly variable, often 25X1 indirect, and usually limited political influence in the focus countries. This influence is greatest in areas dominated by technocrats. For example, in South Korea there is a high premium on good policymaking regarding debt management, and consequently technocrats play a key role in this area and, through them, IMF and World Bank influence on debt policy is considerable. Both Indonesia and Malaysia seek and receive World Bank loans, and both tend to have relatively positive relationships with the IMF. In Indonesia, macroeconomic policy has largely been under the control of technocrats, with whom most IMF-World Bank discussions take place. In Malaysia the IMF and World Bank are viewed as good sources of advice on debt containment and adjustment to commodity price changes, but have little direct policy influence. In Brazil and the Philippines, IMF and World Bank influence has been both direct and at a high level. Both are restructuring debt, seeking new funds and facing down the international banking community. As a result, discussions with the IMF/World Bank group must be managed at the highest political decision-making level. [redacted]

25X1

#### Trends and Implications

Changed political and social conditions, as well as economic opportunities and constraints that have been altered by economic development, all prompt policy shifts. Several such trends in trade policy formulation -- most with implications for US interests -- can be observed in most of the focus countries. [redacted]

25X1

Market Orientation. The rise in real incomes and the increased complexity of the focus country economies have broadened the base of support for less centralized market-based economic policies. This has happened at the same time that abstract theoretical models are being abandoned in favor of lessons of experience. Relatively more open economies have weathered the external shocks of recent years better than economies characterized by a great deal of protectionism. Such economies have been able to make necessary adjustments more quickly and with relatively less cost. [redacted]

25X1

The trend toward both domestic economic and trade liberalization is clearly visible in South Korea and Taiwan. Similar trends exist in Indonesia, Malaysia, and Brazil, although together with targeted import substitution. In Brazil there is also growing political resistance to liberalization and there are debt service pressures to restrain imports and push exports. [redacted]

25X1

Technocratic Policymaking. There is a tendency to modernize bureaucratic processes -- to rely more on technocrats and less on political bureaucrats. Because of their educational background in Western economics and the greater weight they give to objective economic criteria, technocrats tend to favor more liberal policies than do political bureaucrats. Technocrats also present much more sophisticated and well-thought-out positions in economic negotiations, and are able to play by the rules-of-the-game while still finding unprohibited ways of promoting favored industries. [redacted]

25X1

While greater technocratic orientation and competence may make negotiations more difficult, these governments will also become more open to solid technocratic evidence on the benefits of, for example, trade liberalization or expanding foreign direct investment. It will probably become more likely that LDC officials will at least comprehend US arguments

that developed country international economic initiatives are in the mutual interest of industrialized and developing nations. [redacted]

25X1

Political Liberalization. Although extragovernmental pressure groups generally have relatively little influence, slow political liberalization in most of the focus countries is broadening the range of potential influences on trade policy to include both export-oriented groups, which desire trade liberalization, and inward-looking industrial groups, which want protection from imports. Because it is safer for opposition groups to express themselves in the less politically-sensitive area of economic policy, trade policy has sometimes become a political football. In some countries, these trends have resulted in an increase in protectionist pressure, notably in South Korea, but also in Brazil, Taiwan, and Malaysia. [redacted]

25X1

#### Implications for the United States

The United States may find that the increased ability of interest groups in LDCs to influence their governments may create greater resistance to US negotiating objectives at a time -- this year's start of a new GATT round -- when such a trend is particularly undesirable. On the other hand, the increased receptivity to market-based development and the rise of technocrats at the expense of traditional bureaucrats should make LDCs more receptive to liberalized trade policies. [redacted]

25X1

In most of the focus countries, constituencies favoring trade liberalization are weak, but outside action might strengthen them. Public support from official and private US interests for the positions of specific groups and individuals, or including those interests in special meetings or events, could be appropriate, depending on the country, the interest involved, and the timing. Sympathetic foreign interest groups could be promoted more

CONFIDENTIAL

subtly by designing negotiations that implicitly support their efforts or by merely taking care to avoid unnecessarily weakening their positions as US policies are crafted. Nevertheless, with the limited exceptions of Brazil and Malaysia, trade policy in the focus countries can in most cases still be significantly influenced only through contact with at least cabinet-level officials.

25X1

25X1

These annexes describe and assess the trade policy formulation process and the factors that impinge upon it in each of the focus countries -- Brazil, Indonesia, Malaysia, the Philippines, Singapore, South Korea, and Taiwan. [redacted]

Annex 1

Brazil

The increasing influence on policy being exercised by business interests and by the legislature under the New Republic has reinforced Brazil's historic tendency to favor domestic industrial development and protection over export promotion. There are no significant political groups with an external trade orientation. Concern with trade promotion remains largely intermittent -- receiving attention only in response to external shocks and pressures restricting domestic economic growth. Consequently, trade policy and export promotion are still largely ad hoc. This adds to the complexity and cost of the trade regime. [redacted]

25X1

Economic Policy

Brazilian economic policy has been very different from the policies of the other focus countries. In Brazil import protection and import substitution have historically been treated not as temporary steps to groom industries for international competition, but rather as a central part of the economic development process, a process oriented predominantly on the domestic market. [redacted]

25X1

Brazil, while achieving fairly rapid economic growth, has suffered from massive recurring fiscal deficits, large periodic swings in the real exchange rate, and an extraordinarily rapid rate of inflation, even by Latin American standards. In recent years, however, adjustment to the debt problem has

CONFIDENTIAL

forced a severe decline in output and an even larger drop in per capita real income. Although the economy is recovering, it has not yet regained pre-crisis levels, and, despite rapidly rising exports, the debt burden remains extremely high. [redacted]

25X1

Social Structure

The major social divisions in Brazil are along income distribution lines. Although there is social unrest in areas of urban and rural poverty, the poor have presented no organized challenge to the governing elites. The main focus of policy has been to accommodate the interests of the elite, while using growth to prevent popular unrest. In addition, the government is deeply institutionalized and Brazil is well past the nation-building traumas that many LDCs have gone through more recently. [redacted]

25X1

Because of its size, Brazil has always been relatively inward looking. In addition, rural and other outward-oriented interests have become too weak politically to balance protectionist pressures. The economic restructuring that occurred during the Great Depression and World War II shifted the power base of the government away from the more export-oriented raw materials and agricultural sectors to import substitution manufacturing. Policies designed to protect that base after the war, including price controls on agricultural products and protectionist trade policies, continued to weaken the more outward-oriented sectors. [redacted]

25X1

The rapid growth of manufactured exports since the mid-1960s and the debt crisis have somewhat strengthened the liberal economic constituency. However, it may be difficult for the government to move toward a more open economy, even if it wants to, because of the increased voice that recent opening of the political system will probably give to urban populations. [redacted]

25X1

CONFIDENTIAL

CONFIDENTIAL

Political System

Brazil remains an elitist country with large social and income disparities, as well as major regional inequalities. Democracy in Brazil is a system of limited pluralism, intra-elite competition and consensus. The elite groups have endorsed pragmatic policymaking, downplayed ideology, displayed a propensity for compromise, and stressed highly personal or charismatic forms of leadership while avoiding issue-oriented or class-based politics. They have expanded political participation when necessary -- such as the current incorporation of the middle-class and industrial interests into the New Republic -- while still largely excluding the masses.

25X1

The recently increased openness of the policymaking process is partially a result of the increased role of Congress. Under the military government Congress served as a rubber stamp, but under the new administration it has true power. The government must bring broad policy issues before Congress for approval. Officials are determined, however, to avoid allowing Congress to legislate on specific policy, partially because they view its members as inexperienced.

25X1

Policymaking

Reflecting the relatively closed nature of the political system, Brazilian decisionmaking has traditionally been an intra-governmental affair. Interest group representation has been largely corporatist, although Brazil's "economic miracle" led to the formation of new autonomous interest groups.

Under the New Republic, these extra-bureaucratic groups influence Congress and have contacts with important ministers. Policymaking today is

25X1

CONFIDENTIAL

CONFIDENTIAL

therefore more open and, to some degree, more conflictual. Policy initiative remains centered in the executive, but Congress is beginning to assume a limited lawmaking role, and this role is likely to increase in the long run.

[redacted]

25X1

The Brazilian government is based on an unstable coalition between two rival centrist political parties -- the PMDB and the PFL. The President, Jose Sarney, is a compromise figure without a strong political base. His lack of political strength has made it difficult for him during most of his first year to make the policy decisions necessary to deal with Brazil's problems, although his recent anti-inflationary economic program has received wide support.

[redacted]

25X1

Under Sarney the most influential individuals are members of the President's "kitchen cabinet." Key members are the President's daughter Roseana Sarney Murad, her husband Jorge Murad, and the President's wife Marley Sarney. Everything coming from or going to the President must first go through them. Aluisio Alves, the Minister of Administration, and Jose Aparecido de Oliveira serve Sarney as political advisors. Luis Paulo Rosenberg, on Sarney's personal staff, is the single most influential figure in economic policymaking. He is a main force in negotiations with the IMF. Another personal advisor who has had an important role in economic policy debates is Celio Borja. Borja has taken a strong stance in favor of opening up the Brazilian financial market to foreign business.

[redacted]

25X1

Finance Minister Dilson Funaro is a successful businessman with close connections to a group of development-minded entrepreneurs led by Antonio Ermirio de Moraes. A personal friend of President Sarney, Funaro has become probably the second most powerful economic policymaker. His two main aides are Luiz Gonzaga de Mello Belluzzo and Joao Manuel Cardoso de Mello. Also a

CONFIDENTIAL

CONFIDENTIAL

powerful figure in Brazilian economic policymaking is Minister-Chief of the Planning Secretariat of the Presidency Joao Sayad. Although he lacks personal ties with Sarney, he has close ties to the Federation of the Industries of the State of Sao Paulo (FIESP), an important business group. Sayad is a strong advocate of privatization, more growth-oriented strategies for dealing with Brazil's economic problems, and negotiated interest relief. Other posts important in trade policy formulation are the central bank governor, the foreign minister, and the head of CACEX, the Foreign Trade Department of the Bank of Brazil which administers the bulk of Brazil's import regulations and export incentives. CACEX, in fact, has much to say in making trade policy even though, on paper, it is an implementing organization.

25X1

Sayad's ties to FIESP point up the increased influence exercised today by extra-governmental interest groups. Industrialists form the most important extra-bureaucratic interest group. Landed interests are influential mainly on regional and land-related issues. Foreign investors, influential under the old Military Republic, have been largely eclipsed by domestic business interests. Other important interests include the heads of the state-owned enterprises (SOEs) who exercise influence individually, although they do not constitute a true interest group, and the military. Beyond their economic and political influence, SOEs have much influence on trade policy and its implementation because many rules do not apply to them.

25X1

The military's position on trade issues is mixed. Before the shift to civilian power, the military government took a more internationalist stance than other elites might have preferred. Nevertheless, the military espouses a very strong national security interest in developing domestic high technology and capital intensive industries. The informatics policies that now are being implemented, for example, reflect these military security concerns. To the

CONFIDENTIAL

CONFIDENTIAL

extent that the military still participates in economic decisionmaking it is largely through their influence on technology policy. [redacted]

25X1

Unless a worsening economic situation plays into the hands of extremists such as Janio Quadros and Leonel Brizola, the Constitution will probably be rewritten after the November 1986 elections and a parliamentary system established. Under such a system the role of the legislature in policy formation will probably continue to expand. Interest groups will also play an increasing role. [redacted]

25X1

Trade Policy Implementation

There is a great deal of administrative discretion in the implementation of policy. This fact, combined with the complexity of the procedures required to export or import, the unequal treatment of different products, and a low degree of automaticity, has created an extremely slow export regulatory process which has resulted in a strong anti-trade bias in the administrative structure. [redacted]

25X1

The size of the Brazilian economy and the limited role of trade in stimulating growth has accounted for the low priority traditionally given to trade policy. Brazil has one of the more closed major economies in the world, with exports representing only about eight percent of GDP. Exports have not normally been an important source of growth. High debt payments and oil import bills have both, at different times, forced Brazilian policymakers to focus on the external sector and on export promotion. However, once the crisis has passed, the tendency of policymakers has been to turn inward once again. [redacted]

25X1

The ad hoc character of trade policy has meant that no systematic efforts have been made to reform the old import substitution structure and replace it

CONFIDENTIAL

CONFIDENTIAL

with a rational system of export promotion. As a result, large export incentives have been necessary to overcome the anti-export bias of the protection structure as Brazil has tried since the mid 1960s to diversify its industrial exports and trading partners. In recent years, the nation's balance of payments difficulties have prompted the government to impose a variety of new controls on imports. Despite intermittent, half-hearted attempts at liberalization, the focus has been on restricting imports in order to reduce foreign exchange expenditures in the short-run. However, Finance Minister Funaro has favored an increase in imports as part of his pro-growth strategy. [redacted]

25X1

The complexity of the export incentive system that was instituted to compensate for protectionist policies has discriminated against smaller firms. Small firms lack the resources to maintain special units to follow changes in incentives, process applications for incentives, and fight through the bureaucratic machinery. Consequently, most of Brazil's large exporters are either MNCs or state-owned firms. [redacted]

25X1

#### Outlook

Despite the increased openness of the policymaking process, the absence of major domestic interest groups with an export orientation does not bode well for any fundamental policy changes. Indeed, if anything, the increased influence of domestic business interests has strengthened the existing tendency to promote growth in favor of adjustment and to institute new protectionist measures rather than to liberalize imports. As a result, a consistent, trade-promoting policy is probably unlikely in the near future. Ultimately, however, debt problems, high inflation, and unstable growth will force some improvements in the management of state enterprises and the system

CONFIDENTIAL

**CONFIDENTIAL**

of industrial and trade regulation. Still, Brazil will remain inwardly  
oriented.

25X1

**CONFIDENTIAL**

CONFIDENTIAL

## Annex 2

Indonesia

Indonesia's relatively large domestic market and the income it derives from its oil exports have supported a highly protectionist trade policy. Import substitution has become the primary means of stimulating industrialization. This policy bias has been reinforced by the Indonesians' long dirigisme tradition and distrust of the market. Although the decline in the country's oil exports has recently forced some policy reforms, the resistance to liberalization remains strong. Major reforms are unlikely due to a strong national ideology that is suspicious of international trade and investment and because it would be opposed by important political interests in the bureaucracy and the business community that benefit from the high level of protection.

25X1

Economic Policy

Indonesia has trappings of a modern economy, financed largely by oil exports, superimposed on a largely underdeveloped rural economy. Primitive conditions and poor communications between the country's numerous islands, and even within the major islands, have created extremely segmented internal markets, on which local political and military authorities have great influence. The large oil income has financed governmental functions, infrastructure construction, and selective industrial development, including

CONFIDENTIAL

CONFIDENTIAL

the creation of state enterprises. The Indonesian government has worked slowly to improve the operation of domestic markets, to enhance human capital and infrastructure, and to create at least some incentives for diversification of the economy and of exports. In particular, it has avoided the policy pitfalls that have been so prevalent in the large oil exporting countries -- namely, to allow the exchange rate to become grossly overvalued in relation to any export product except petroleum in order to hold down import prices and sustain urban real wages (the so-called Venezuelan, Mexican, or Nigerian disease). Although there has sometimes been considerable inflation, Indonesia has not allowed the exchange rate to appreciate seriously, so that it has not destroyed its existing non-oil export industries, or made it virtually impossible to develop new exports. Moreover, it has restrained the growth of debt to manageable levels.

25X1

#### Social Structure

Indonesia one of the most diverse societies in the world, but the fact that Indonesia's social divisions crosscut rather than coincide mutes their political impact. In addition to conflict between traditional Chinese business interests and the rising Malay business class, which Indonesia shares with Malaysia, important religious divisions exist between orthodox Moslems, nominal Moslems, and Christians. These differences cut across ethnic and regional distinctions. The Javanese, for example, are the most numerous and dominant ethnic group in Indonesia but are religiously divided. This is fortunate for Indonesia since a unified Java would have created an even sharper division between the inner and the outer islands that might have torn the young country apart.

25X1

The government's response has been to maintain control over its highly

CONFIDENTIAL

CONFIDENTIAL

divergent and widely scattered people and territory through a military territorial structure, repression, and an attempt to impose a sectarian, non-ethnic philosophy -- Pancasila -- intended to co-opt major interest groups. The distribution of economic growth gains has been central to the co-option and power balancing process. The government favors Malay business interests (pribumi) and protects them from "unfair" competition from imports, domestic Chinese-owned firms, and foreign businesses. This has contributed -- along with Indonesia's bureaucratic tradition, rampant corruption, and President Suharto's tendency to issue personal decrees -- to gross overregulation of the economy. [redacted]

25X1

Despite high oil earnings, and the resulting import capacity, Indonesians remain highly suspicious of trade and foreign involvement in the economy. Yet, the Suharto government's ability to restrain the centrifugal social forces in Indonesian society has been based heavily on oil income. The economic growth stimulated by the oil sector has provided the means to keep the out-groups relatively appeased, while the government has pursued inefficient industrialization policies that contain significant price distortions. The drop in oil prices since the early 1980s, however, has forced a variety of policy improvements. [redacted]

25X1

#### Political System

The Indonesian political system has a dominant presidency, a politically active military, a decisionmaking process centered on the president, and a pattern of state-society relations that combines cooption and responsiveness with repression. The pattern of state-society relations in Indonesia is unusual in that the political parties -- including the government supported Golkar -- play only a marginal role in social management. Instead, the

CONFIDENTIAL

CONFIDENTIAL

overlapping regional administrative structures of the army and the Department of Home Affairs have assumed responsibility for social control. The parties play only a legitimizing role. [redacted]

25X1

The Indonesian military dominates political life. Military men hold all security posts and most important political offices, as well as the majority of the large state-owned enterprises that dominate the economy. Military control over political, economic, and security affairs is exercised under, and justified by, the military's dual role (dwi fungsi) philosophy. [redacted]

25X1

The key opposition to the Suharto government is in Indonesia's growing orthodox Muslim (santri) community. Government leadership and most of the military are either nominal Muslims (abangan) or Christians. The government is widely believed to be hostile to the orthodox Muslim community, which it suspects of wanting to transform Indonesia into a Muslim state. Recent government policies limited peaceful Muslim political expression, driving the Muslim opposition underground. [redacted]

25X1

Since 1983 President Suharto has moved to centralize power and eliminate all alternative or potential centers of power, bringing all political parties, unions, social groups, and religious organizations under state control. One of the motivations appears to be an expectation of difficult economic times due to the downturn in the oil market and the slump in other commodities markets. It is also thought that Suharto may be preparing for succession. Although he has not groomed a successor and no likely candidate is apparent, Suharto is promoting turnover in the officer corps and Golkar. [redacted]

25X1

#### The Policymaking Process

Policymaking in Indonesia is a personalistic process. Suharto dominates, serving as the fulcrum for the resolution and reconciliation of Indonesia's

CONFIDENTIAL

CONFIDENTIAL

conflicting policy interests. Suharto has consistently resisted depending exclusively on any one group or individual. Instead, he has manipulated the individuals and interests that revolve around him, exploiting their personal and political differences so that they remain in competition with each other and dependent upon him for victory in policy disputes. [redacted]

25X1

Traditionally, three types of power holders have existed in the "New Order:" members of the "inner core" group of officers who enjoy close personal, as well as working, relationships with Suharto; members of the "core" group of officers around Suharto who enjoy good working relationships with the President; and the military and technocratic leadership of the government. There are no extra-governmental interest groups. Cronyism exists through relationships between Chinese businesses (cukongs) and army officers. Suharto has close ties to several cukongs. Cukongs have some policy influence, but its extent is difficult to measure. [redacted]

25X1

There are three important elements in the economic and trade policymaking apparatus:

The State Secretariat (Sekneg), has primary responsibility for economic regulation, overseeing government procurement, and monitoring foreign and domestic investment. Sekneg is bureaucratic, nationalistic, protectionist, and obstructionist. Sekeng is headed by State Secretary Sudharmono, whose faction controls the organization. Important members of the Sudharmono faction include: Ginandjar Kartasasmita, Junior Minister for Domestic Product Production and head of the Capital Investment Coordinating Board (BKPM); Major General Abdulrachman Ramp, the head of Pertamina, the state oil company; Lt. General Ali Said, Chief Justice; and Ismail Saleh, Justice Minister. [redacted]

25X1

"The Berkeley Mafia," a popular appellation applied to a group of American educated technocrats (unofficially led by Prof. Dr. Ali Wardhana,

CONFIDENTIAL

CONFIDENTIAL

Coordinating Minister for Economics, Finance, and Industry) who are in charge of macroeconomic policy. These men believe that Indonesia's continued growth in the long term depends on promoting nontraditional exports and that domestic industries must become more competitive in the international marketplace. Consequently, they favor lowering trade barriers and allowing market forces greater influence. In addition to Wardhana, the group includes Prof. Dr. Johannes B. Sumarlin, Minister of State for National Development Planning and Chairman of Bappenas (the state economic planning agency); Prof. Dr. Emil Salim, Minister of State for Population and Environment; and Prof. Dr. Subroto, Minister for Mining and Energy. Two former cabinet officials who are still influential, Widjojo Nitisastro, previously Coordinating Minister for Economics, Finance, and Industry, and Mohammad Sadli, formerly Minister of Mining, are also part of the group. Their mentor, Sumitro Djojohadikusumo, continues to serve as an unofficial economic advisor to Suharto.

25X1

The "Political Economists," based in the sectoral ministries, are the rivals of the Berkeley group. Responsible for microeconomic policy, this group tends to employ a personalistic style of policymaking -- trading on their personal influence with the President and making policy in an ad hoc fashion. They favor insulating local industry from foreign competition. Their goal is to boost employment by developing a balanced industrial capacity producing mainly for the domestic market. The recent decline in export earnings has strengthened their protectionist position. Faced with declining economic growth, Indonesian officials have responded by putting more emphasis on import substitution policies. The best known advocate of these policies and Wardhana's chief rival is Minister of State for Research and Technology B.J. Habibie who is a close friend of Suharto. Another important member of this group is Minister of Industry Hartarto Sastrosienarto.

25X1

CONFIDENTIAL

CONFIDENTIAL

Because Indonesian bureaucrats generally distrust the market and prefer to rely on state intervention, the liberal trade and economic policies advocated by the "Berkeley" technocrats mark them out as "mavericks." Typically, Sekneg and sectoral ministries support each other against the "Berkeley" technocrats, although Sekeng at times comes into conflict with the "political economists" because its obstructionist regulatory methods frequently hinder their investment projects. The protectionist position is also supported by the cukongs who benefit from eliminating foreign competition.

25X1

Suharto, in his fashion of employing "creative tension" among his advisors, manipulates these groups. Consequently, Indonesian economic policymaking shows a mix of policy styles and orientations. Although one or more elements in the economic policymaking elite may gain the advantage over their rivals as a result of changing events, it will be a temporary phenomenon. As long as Suharto rules, it is unlikely that any group will have things all its own way.

25X1

#### Trade Policy Implementation

Industrialization has taken place behind high barriers and has consequently produced inefficient and uncompetitive industries. Regulation is carried out through licensing of new enterprises, import restrictions, and investment incentives.

25X1

Administrative discretion tends to be high, which -- combined with complex administrative procedure, unequal treatment, high abuse, and low automaticity -- serves to create an extremely slow regulatory process and results in a strong anti-trade bias in administrative behavior. The regulatory system gives officials vast opportunity for graft at many stages of

CONFIDENTIAL

CONFIDENTIAL

the approval process. Indonesia's bureaucratic approach is carried over into its economic planning, which includes explicit performance targets for both government entities and private firms. Indonesia is the only focus country to employ such detailed planning. [redacted]

25X1

Indonesia has promoted non-oil exports with measures ranging from countertrade to financial and fiscal incentives. The most important element in Indonesia's efforts to expand its non-oil exports, however, has been its exchange rate policy. In general, Indonesia's exchange rate policies have been managed successfully by Suharto's macroeconomic policy team to provide fairly stable trade incentives. Despite Indonesia's recent efforts to promote non-oil exports, the overall trade regime remains strongly biased against both exports and imports. Perhaps the sole exception to Indonesia's largely isolationist economic orientation is its membership in ASEAN, but ASEAN's importance to Indonesia is more political than economic. [redacted]

25X1

#### Outlook

Suharto has ruled Indonesia for twenty years. His critical role in the government and the low level of institutionalization of the regime make a stable succession questionable. Although he remains reluctant to establish a successor, since 1983 Suharto has stepped up the process of institutionalization in order to make his regime outlast him. As Suharto further institutionalizes his regime, policymaking will certainly become increasingly technocratic and bureaucratic with decreasing personalistic elements. [redacted]

25X1

In the short-term, economic pressures are more likely to be handled through "band-aid" responses rather than through structural and policy reform. Continued economic growth, however, will require significant reforms

CONFIDENTIAL

CONFIDENTIAL

to increase the efficiency and international competitiveness of Indonesian industry. For major reforms to occur, the political influence of interests benefitting from protection and the power of the state bureaucracy will have to be reduced. However, we believe such a major change is unlikely. Efforts from outside to encourage reform would probably meet with little success [redacted] 25X6  
[redacted] and could damage 25X6  
the position of domestic reformers. [redacted] 25X1

CONFIDENTIAL

CONFIDENTIAL

## Annex 3

Malaysia

Trade policy in Malaysia is subject to many, often conflicting influences. Minimizing tensions among the Malay, Chinese, and Indian populations is Malaysia's dominant national imperative. However, the government also favors the Malay community in economic development, and this has led to import protection for selected industries. The economy is large enough for some domestically-oriented industry, but is too small to avoid a predominant orientation toward exports. The decline in oil, tin, and other commodity prices combined with protectionism in the industrial countries have presented Malaysia with major economic challenges, both in terms of overall development and achieving the distributional goals of the New Economic Policy (NEP). These challenges have intensified pressures to diversify export products and markets, and also have strengthened some interests seeking increased protection. [ ]

25X1

Economic Policy

The Malaysian economy, although larger and less open than Singapore's, has also been one of the least distorted among LDCs. The government has kept the exchange rate tied to the major world currencies, held inflation far below world standards, placed few restrictions on imports, and interfered little with business decisions. The terms of trade changes in the 1970s favored

CONFIDENTIAL

CONFIDENTIAL

Malaysia. Policies introduced in the early 1970s to raise the economic level of the Malay community and the decline of earnings from oil and other primary product exports in the past two years have resulted in selected import substitution in manufacturing, but on a relatively small scale. The growth of debt has been a concern, but Malaysia is not a problem debtor. [redacted]

25X1

### Social Structure

In Malaysia the government tries to balance the divergent ethnic and religious interests through a process of political compromise rather than through repression and corruption [redacted] but like Indonesia, the government favors the Malays. The major objective is to achieve sufficient economic growth to rapidly improve the well-being of the Malays without reducing that of the Chinese and Indians. The landed Malay aristocracy and other rural Malays form key elements of the power base for the ruling party, and export-oriented agriculture is a key economic sector. This political base has been a major source of Malaysia's conservative and outwardly oriented development strategy. [redacted]

25X1

25X1

### The Political System

Trade policy is formulated within a highly centralized and bureaucratic political system, although Malaysia's parliamentary structure provides for wider participation than in the other focus countries. Nevertheless, the prime minister and the cabinet hold decisionmaking authority within the government. The interests of different groups are weighed within this centralized format. The most important party in the dominate National Front coalition is the United Malays National Organization (UMNO). Its power has grown since the early 1970s relative to its major partners, the Malaysian

CONFIDENTIAL

CONFIDENTIAL

Chinese Association and the Malaysian Indian Congress. Parties or interest groups not represented in the National Front have few channels through which to influence decisions. [redacted]

25X1

Policymaking

Determining trade policy depends more on personal influence than on institutional authority. A small clique dominates the major political parties, cabinet appointments, and boards of directors of public corporations. This concentration of power further increases the ability of particular individuals to influence trade policy. Malaysia's economic and trade policy process, however, is more open and visible than that of any of the other focus countries, except Brazil. [redacted]

25X1

Prime Minister Mahathir, in consultation with his closest advisors (including cabinet officials, the UMNO hierarchy, and several informal advisors), initiates trade policy. Within the cabinet, the Ministry of Trade and Industry (MTI) and the Ministry of Finance wield the most influence on economic and trade policy. MTI is responsible for licensing and regulating domestic and foreign firms and for ensuring that they conform to NEP employment and equity guidelines. Mahathir headed the ministry before 1981 and left a strong bias in favor of capital-intensive heavy industry. The Ministry has been headed by Razaleigh Hamzah since 1984. Although he acts more independently from Mahathir than his predecessor, Ahmad Rithaudeen, Razaleigh tends to support greater government involvement in direction of the economy, and can be expected to follow Mahathir's lead in the use of selective import substitution policies to promote the nascent heavy industries program. [redacted]

25X1

The Ministry of Finance (MOF), headed by Daim Zainuddin, has tax and

CONFIDENTIAL

CONFIDENTIAL

tariff setting responsibilities. Specific policy actions are implemented in its annual budget. Authority for granting specific protection is shared with MTI. MDF and MTI, with others, have recently drafted an "Industrial Masterplan," which seeks to revise the entire system of taxes, tariffs, and financial incentives. With his highly successful business background, Daim appears to support free trade in most areas. However, he supports Mahathir's promotion of heavy industries. [redacted]

25X1

Other ministries, statutory bodies, and public corporations participate in trade policy formation through their influence on cabinet members and the Prime Minister's office. These other organizations, ranging from the generally pro-trade Foreign Ministry to the usually highly protectionist large public corporations that have been formed to promote Malay interests, intervene mainly on specific issues that fall within their areas of responsibilities. [redacted]

25X1

An array of special interests interact in this process, primarily through links with established political parties. The emergence of new political leaders in UMNO is creating pressure to open up the policymaking process to influence from new sources, and is also increasing dissension within the party over economic and trade policy. The major differences have been between new Malay businessmen, who have benefited from protectionist policies under the NEP, and the traditional Malay aristocracy, which prefers a more outwardly oriented trade policy. Some of the more successful businessmen, however, are beginning to support a more open trade regime. [redacted]

25X1

The Malaysian Chinese Association (MCA), the second party in the coalition, acts as a conduit for Chinese opinion and cooperation and has served as the primary source of influence for Chinese businessmen, who prefer a liberal trade regime. However, the MCA's support within the Chinese

CONFIDENTIAL

CONFIDENTIAL

community and its ability to influence the policies adopted by the National Front have gradually eroded under the NEP. [redacted]

25X1

Trade Policy Implementation

Because legislation tends to be very general, its impact is largely determined by implementation. Implementors -- bureaucrats, state and local officials, and public corporations -- have fairly broad discretion to interpret new economic and trade laws. Administrative procedures are moderately complex. The system is rather sluggish, if relatively visible, but does not suffer from serious abuses. [redacted]

25X1

Although the decision-making style of the government allows substantial administrative discretion, a commitment to economic planning has systematized economic policymaking. The planning agencies are dominated by the Prime Minister's office, but take into consideration the opinions of other ministries in an extensive process of negotiation and compromise that is used to build support for economic policy. [redacted]

25X1

Malaysia, however, does not prepare an overall trade plan. Instead, the needs of each industry for protection are determined on a case-by-case basis. The Tariff Advisory Committee of the MIDA oversees tariffs. The committee usually is willing to grant tariff protection and import restrictions to new companies. Currently the tariff structure favors large firms at the expense of the small-scale industries. An incentive system favors industries that produce for export, even if they operate merely as assemblers and add little to the value of the products or to the skill of the labor force. Malaysia has developed a dualistic manufacturing system with a highly competitive export sector, located in the free trade zone, and a less efficient domestic sector, producing in a protected environment for the

CONFIDENTIAL

CONFIDENTIAL

domestic market. Malaysian policymakers are implementing plans to simplify tariffs and incentives and make them conform more fully to the country's development goals. [redacted]

25X1

Nevertheless, Malaysia is also beginning a new round of selective import substitution. The new measures are designed to reduce the amount of foreign exchange spent on consumer durables, intermediate inputs, and capital goods. Since intermediate inputs into manufacturing are a large proportion of Malaysia's imports, the government hopes to begin domestic production of some of these products. Industries targeted for protection include household appliance components, sound equipment, telecommunication equipment, coastal ships, and automobiles. [redacted]

25X1

Malaysia is trying to diversify its export markets for manufactures. The Ministry of Trade and Industry has assumed responsibility for formulating new plans to improve exports. Malaysian diplomatic missions have been instructed to pay closer attention to Malaysian business interests in foreign countries. The government has also encouraged the establishment of large trading conglomerates as part of its "Look East" policy, which attempts to copy aspects of successful South Korean and Japanese economic development.

[redacted]

25X1

### Outlook

Prospects are good for greater competition within UMNO as new political leaders try to open the policymaking process and dissatisfaction with the National Front increases as economic growth rates slow. However, the National Front will continue to dominate the political system. [redacted]

25X1

The economic outlook is somewhat troubled, with the collapse of oil and other commodity prices sharply reversing the beneficial terms of trade changes

CONFIDENTIAL

CONFIDENTIAL

of the 1970s. Although manufacturing now accounts for nearly 40 percent of Malaysia's exports, major export industries have suffered from over-production (semi-conductors) and growing protectionism (textiles).

25X1

The outlook for trade policy is mixed. The recently released "Industrial Master Plan" proposes reducing tariffs, taxes, and regulations to promote exports. Some measures to liberalize the economy have already been introduced: strict regulation of foreign equity ownership has been relaxed for certain industries; a few of the public corporations established since 1971 have been sold to private investors; personal and corporate tax rates and some import tariffs have been lowered. At the same time, promotion of heavy industrial development involves increased selective government targeting, utilizing quotas, tariffs, and other forms of protection. However, the country is too small, and the need to grow rapidly too great for the government to be likely to embrace a broad import substitution program.

25X1

CONFIDENTIAL

Annex 4

The Philippines

Although the Philippines is in a state of transition, there are indicators of possible directions of policy change, but time will be required to identify the economic and trade policy biases of the new government. The Philippines has been an inwardly oriented country, with this bias supported by the structure of trade policy. Even though import policy was explicitly liberalized, and selective export promotion adopted after the early 1970s, the structure and implementation of trade policy retained a strong import substitution bias.

[Redacted]

25X6  
25X6

Economic Policy

In the Philippines the role of government in the economy is far less pervasive than in Korea and Taiwan, but is also less coherent. The government has not provided much leadership for economic development, but has mainly responded to events. Until the later part of the Marcos administration, the government had little role in exports of agricultural and wood products, the mainstay of Philippine exports, but the policy mix tended to bias against both domestic and export agriculture. At the same time, industrialization has been

CONFIDENTIAL

dominated by incentives for import substitution since the 1950s. The degree of distortion caused by the policy bias was limited by a shift away from direct controls towards a more market-based policy approach, especially after the late 1960s. In consequence, the price structure in the Philippines was not subject to severe distortions, at least until recently. [redacted]

25X1

Periodically, large fiscal deficits have developed in the Philippines, resulting in higher inflation, an overvalued exchange rate, a growing black market in foreign exchange, and ultimately a devaluation. The trade regime continued to be characterized by high and variable tariffs, nontariff barriers, and foreign exchange controls. Export promotion was piecemeal and highly complex. The result of all this was average economic performance for an LDC. [redacted]

25X1

There was a clear shift in the late 1970s to liberalized trade, promotion of basic industries, and restructuring of a number of key industries, but the quality of economic policy deteriorated severely during the last few years of the Marcos regime, as cronyism became rampant, government expenditures rose, and the exchange rate became increasingly overvalued. The decline in export earnings was largely covered by foreign borrowing, resulting in a severe debt problem. Steps to cut imports and reestablish export incentives were not taken until 1984, and the economy has since been in severe recession at a time when most of the other major LDC debtors were into recoveries. [redacted]

25X1

#### Social Structure

Ethnic, religious, and regional divisions are relatively minor. The main social divisions are income-based and are associated with a severe rural/urban split. Although the Philippines is beyond the nation-building stage of its political development, it faces a serious internal threat in an armed

CONFIDENTIAL

CONFIDENTIAL

communist insurgency. From the late 1970s, there was a rapid growth of the armed insurgency, and a fracturing of political support for and control of the Marcos machine. Without sustained economic progress, at least partially distributed back to the rural areas, Marcos was unable to consolidate and enhance the substantial national support given to him personally and to his early "new society" policies. The result was his sudden descent from power as the nation coalesced behind Corazon Aquino. [redacted]

25X1

The Church, the military, much of the business community, and the urban population support Aquino. However, large parts of the rural population have been neutral or opposed. In part, this reflects the strength of regional warlords, Marcos supporters, and the communist New People's Army, but it is primarily a result of the terrible state of the rural economy. Among the many challenges facing Aquino, perhaps the most pressing is achieving an economic recovery that extends to rural areas and to the urban unemployed. The need for rapid economic gains may create conflicting pressures on trade policy. Long-term success will require a more open economy. However, responding to calls for special import protection may produce short-term gains but could also slow economic progress in the long-run. [redacted]

25X1

### Political System

Even before Marcos, the Philippines government was a centralized patrimonial democracy. Strong leaders with large personal followings tended to form loose coalitions behind more-or-less stable party designations, but without strong party commitments. Indeed, individuals frequently shifted from party to party with their followers. The office of the president conferred national power, and that had to be won in the competitive political arena. The various presidents ruled in a strong personalistic style, although they

CONFIDENTIAL

CONFIDENTIAL

were constrained by the legislature, the courts, and the next election. The institutions that offered countervailing power to the office of the president were greatly eroded under martial law and the strong, traditional Filippino patrimonial style became even more deeply entrenched in the bureaucracy than before. [redacted]

25X1

With Marcos' departure, the authoritarian style of government will probably become more democratic, and power will become more institutionalized. Nevertheless, given the nature of Filippino politics and its social structure, the system's style will probably remain strongly patrimonial. Although it has promised a new constitution and elections, the Aquino regime has dissolved parliament and is governing by decree. Tension between the flexibility these moves give to policymaking and the new president's apparently strong commitment to ethical, democratic institutions will probably characterize intra-cabinet debate for months. [redacted]

25X1

### Policymaking

Under Marcos, economic decisionmaking was dominated by the president's authoritarian, personalistic style. Decremaking powers were used extensively and on an ad hoc basis. Nevertheless, the various economic ministries were organized along modern bureaucratic and technocratic lines. Although the ministries were packed with Marcos supporters, the problems caused by the high debt burden and mismanaged firms made it necessary to appoint highly qualified technocrats to some senior positions, if only for legitimizing purposes. Major decisions were made by the president, but the ministries were permitted to make some decisions based on technocratic criteria. [redacted]

25X1

The Aquino government owes debts to a wide range of political forces, including its military supporters. Private business interests played an

CONFIDENTIAL

CONFIDENTIAL

important supporting role, as did the elite "landed" interests that had been suppressed since the beginning of martial law. The trade policy biases of these groups are mixed, but all seem inclined to move towards a more stable and level playing field. [redacted]

25X1

The new constitution, whatever its form, will return an important lawmaking role to the legislature. The Aquino regime has retained many of Marcos' ministers and economic technocrats. Given the enormous problems of establishing the new government, gaining control of the countryside, and resuming economic development, the technocrats are likely to increase their political influence substantially. [redacted]

25X1

During coming months the President and her cabinet will make all of the key decisions, but Finance Minister Jaime Ongpin and Trade and Industry Minister Jose Concepcion will be particularly important in economic and trade policy. Both were company presidents before taking office. Both men have a strong private sector bias, especially the Harvard trained Ongpin, who was an active and vocal critic of Marcos' economic policy for several years. Both men were active members of the Makati Business Club, a private business think tank that concentrated on economic and business policy. Their economic agenda is probably mixed in terms of import protection, import liberalization, and export promotion, mainly due to its heavy domestic policy focus. Just sorting out the domestic problems, however, will sharply reduce the anti-trade bias of the system. [redacted]

25X1

The major short-run challenge to the market-based economic reforms of Ongpin and Concepcion will be the traditional Filipino politicians, most notably Vice President and Foreign Minister Salvador Laurel and Defence Minister Juan Ponce Enrile, who want to set up patrimonial patronage systems as quickly as possible. Economic reforms that limit the formation of such

CONFIDENTIAL

CONFIDENTIAL

patronage networks will likely be strongly opposed by these men. Aquino will determine how these differences will be resolved. Initially, she has supported Ongpin and Concepcion, though not without adding a populist, social welfare twist that reflects her personal biases and the influence of the church, especially Cardinal Sin. [redacted]

25X1

The most controversial interests to be taken account of in economic policymaking are the foreign interests. Domestic political debate characterizes multinational corporations as a symbol of US colonialism, the US military presence, and US support of the Marcos regime. Whether or not the new regime will follow policies that reflect this anti-US multinational view is uncertain, but a large number of Aquino supporters have expressed such views. There is no question that US multinationals have an important economic presence in the Philippines, but, in fact, they have not had much influence on government decisionmaking despite the rhetoric. Indeed, some US businesses actively supported moderate political change in the Philippines in association with local business groups. The political rhetoric is deeply ingrained and the new government would find it difficult to show any support for foreign multinationals. [redacted]

25X1

Similarly the role of the IMF/World Bank group will remain controversial. The Philippines still must restructure debt, seek new funds, and face the international banking community. As a result, discussions with the IMF/World Bank will have to be managed at the highest political decisionmaking levels. [redacted]

25X1

#### Trade Policy Implementation

The concentration of decisionmaking power in Marcos' hands resulted in a complex array of often inconsistent laws. This widened the range for

CONFIDENTIAL

CONFIDENTIAL

administrative discretion, since the administering agency could determine how and when to apply which rules. This situation is almost certain to improve under the new government. Public statements suggest a strong effort to clean up graft and corruption and a commitment to an improved, stable business climate. [redacted]

25X1

Outlook

Regardless of what the new constitution will look like, economic and trade policymaking will certainly remain under strong executive control -- in the short-term it is nearly absolute. Economic policy will be more market-oriented and subject to greater evaluation on technocratic terms than in the past. The economic rules of the game are, therefore, likely to stabilize and improve. Policy inconsistencies will be reduced, implementation will become less discretionary, and the international trade and investment climate will improve. [redacted]

25X1

Strong interests have emerged to eliminate the array of specific protections for crony firms, but other interests and many jobs depend on their continued operation. Given severe financial constraints, the political interests built up around import substitution activities, and the political pressures for fast economic results, a dramatic drop in protectionist barriers is not in the cards. Part of the constituency behind President Aquino has a strong anti-multinational corporation, anti-United States, and anti-IMF/World Bank bias. This will create continuing tensions. However, conditions are sufficiently fluid that interests favoring a more outward orientation could, in time, shift policymaking towards the creation of more efficient markets and significantly reduce the country's anti-trade bias, especially if the United States, IMF/World Bank, and neighboring countries help. [redacted]

25X1

CONFIDENTIAL

CONFIDENTIAL

## Annex 5

Singapore

The vital importance of trade in Singapore's economy has meant that trade policymaking has been inseparable from the process of general economic policy formation -- each has been set by the same limited number of individuals and in the same fashion. Concern about the vulnerability of the economy has induced the leadership to establish a technocratic decision-making system in which policy is based on the technocrats' assessment of international economic trends and Singapore's changing comparative advantage.

25X1

Economic Policy

Singapore not only provides little import protection, but also adjusts its economy almost immediately to external economic changes. With an exchange rate tied to a basket of currencies of its major trading partners and highly conservative monetary and fiscal policy, Singapore keeps its domestic inflation rate well below the rate of global inflation and generally promotes a rapid reallocation of domestic factors of production in response to shifts in relative world prices. The government concentrates on facilitating private response to world market opportunities. It tries to foster development of a well-trained work force, good physical infrastructure, moderate and predictable regulations, and price and financial stability. Singapore's foreign debt is low. Sometimes Singapore pushes the economy too hard -- for

CONFIDENTIAL

CONFIDENTIAL

example, by raising wages to encourage a shift to less labor intensive production, a step that will require substantial adjustment. [redacted]

25X1

Social Structure

Under the leadership of Prime Minister Lee and the PAP (People's Action Party), a strong national identity has been created among a sharply divided population by building the richest (in per capita terms) country in the region out of a highly vulnerable city state. Unlike Indonesia and Malaysia, Singapore has not used ethnic or social group as a criterion of income distribution. Instead, it has created opportunities through work and education in a growing economy, combined with social welfare policies to benefit the disadvantaged. The leadership's relentless pursuit of economic growth largely reflects the challenges it faced in the early years when Singapore was molded into a viable multi-ethnic society. [redacted]

25X1

Political System

Although Singapore is ostensibly a parliamentary democracy, the technocratic values it professes clearly distinguish it from the pluralistic Western model. It is, in fact, a "technocratic democracy." Authority is centered on the cabinet under the direction of a strong Prime Minister. The authority of the government, although subject to periodic electoral review, is based fundamentally on a claim to superior knowledge and wisdom. [redacted]

25X1

The political base for the People's Action Party's (PAP) technocratic policy style is a virtual one-party system in which dissent is minimized and organized opposition stifled. The instruments of control are a combination of political repression and social welfare policies implemented through a pervasive grass-roots organization. The strong political base the PAP has

CONFIDENTIAL

CONFIDENTIAL

developed has enabled its leaders to insulate themselves from direct political pressures, whether mass-based or special interest groups. [redacted]

25X1

Policymaking

Policy issues are treated as an in-house matter, rather than as subjects for public debate. Reflecting the government's ideological aversion to particularism (part of its "multi-ethnic" policy) special interest groups are generally not considered to be legitimate participants in the policy formation process. The technocratic structure clearly is sensitive, however, to the concerns of these interests, even though they are not consulted during the decisionmaking process. Their economic importance makes it impossible for the government to completely ignore them. [redacted]

25X1

In general, economic decisionmaking -- and, political decisionmaking as well -- is highly centralized. Actual policy is set by just a few individuals, usually of ministerial rank. These men are typically highly skilled generalists with multiple job responsibilities. They are troubleshooters who exchange posts readily as the situation requires, rather than bureaucratic specialists. Singapore's top leadership can be separated into two groups -- the "old guard" and the "young guard." The "old guard" includes the men who have led Singapore since the late fifties. The "young guard" are their personally chosen successors. [redacted]

25X1

The "old guard" is led by Prime Minister Lee Kuan Yew, the dominant force in politics and policymaking. His closest associate over the years has been Dr. Goh Keng Swee, former first deputy prime minister and the architect of Singapore's "economic miracle." The other, still active, members of the "old guard" are Sinnathamby Rajaratnam long-time Minister of Foreign Affairs, now Senior Minister in the Prime Minister's office and E.W. Barker, Minister of

CONFIDENTIAL

CONFIDENTIAL

Law.

25X1

Goh Chok Tong, Ong Teng Cheong, and Tony Tan are dominant figures among the second generation leaders. Goh Chong Tong, First Deputy Prime Minister, has emerged as Lee's chosen successor. Although Goh is considered highly capable, he lacks popular appeal. Both Tan and Ong are considered better vote getters. Ong is Second Deputy Prime Minister and chairman of the PAP. Tan, both Trade and Industry Minister and Minister of Education, is the most popular and outspoken, and is believed to be the new cabinet's "peacemaker" -- filling the role played for many years by Rajaratnam and Barker. Another rising star is Lee's son Lee Hsien Loong. Well liked by the other ministers, the younger Lee is considered to be capable and intelligent, and possesses grassroots support. Although a succession mechanism exists and a successor has been groomed, the Prime Minister Lee's unique stature and his long tenure may make succession difficult. [redacted]

25X1

A final figure of considerable importance, but who belongs to neither the "old nor the "young" guard, is Richard Hu Tsu Tau, Goh's replacement as Monetary Authority of Singapore (MAS) chairman. A former businessman, Hu's appointment was partially a move to placate the international financial community, which distrusted Goh, but looks favorably on Hu. Hu's rise also reflects Lee's concern that a future government might draw down Singapore's reserves to finance politically popular policies. Accordingly, Lee has deliberately excluded the young guard from the key government financial posts. Hu, older, new to politics, and with a corporate background, serves the role of guardian. [redacted]

25X1

#### Trade Policy Implementation

Because the leadership considers it essential to maintain its

CONFIDENTIAL

CONFIDENTIAL

international competitiveness, policy formulation and implementation typically have been very responsive to world market forces. The technocrats in the cabinet generally have based their policies upon rational calculations of Singapore's changing comparative advantage within the context of long-run international economic trends. In those cases where market forces have been disregarded or misinterpreted, policy has had to be revised. An example of such an error is the recent reversal of the "high wage" policy implemented in the late 1970s to promote the diversification of the economy into the production of high technology exports. [redacted]

25X1

Although decisionmaking is highly centralized, implementation is more decentralized. It is carried out through a plethora of ministries, statutory boards, and state-owned enterprises (SOEs) in accordance with the development priorities of the cabinet. The most important ministry is the Finance Ministry, which controls the Economic Development Board (EDB), as well as the MAS, and many other important statutory boards. Other important economic ministries include the National Development Ministry and the Ministry of Trade and Industry. Below the level of the ministries are the statutory boards, through which the government directly regulates or participates in the economy. The most important statutory board is the EDB, currently headed by P.Y. Hwang. The EDB, acting under the authority of the Minister of Finance, serves as the overall agency for economic development. The MAS serves as Singapore's de facto central bank and regulates all financial enterprises. Singapore does not maintain a formal planning process. [redacted]

25X1

The government's direction of the economy extends beyond the statutory boards through the large number of state corporations. Even Singapore's SOEs operate largely on economic and business management criteria. Singapore's SOEs are run through three investment holding companies. The oldest and best-

CONFIDENTIAL

CONFIDENTIAL

known is Temasek Holdings, a Ministry of Finance organization for government investments in manufacturing and related service industries. Most of Temasek's investments were undertaken due to a lack of private sector interest. MND Hoblings has spawned companies that provide construction materials and introduce new building technology. Sheng-Le Holding, the most heavily capitalized, is run by the Defense Ministry and was originally designed to provide support systems for the military. It has since become a center for entrepreneurial ventures. [redacted]

25X1

Despite decentralized implementation, the degree of discretion exercised by the bureaucracy in implementing policy is low. Policy control is retained at higher levels. This fact, combined with simple administrative procedures, equal treatment of different products, a high degree of automaticity, an insignificant incidence of abuse, and, of course, Singapore's extremely low level of import protection, have ensured that the time and effort necessary to effect international transactions has remained low -- an important fact given Singapore's dependence on international trade for its economic livelihood.

[redacted]

25X1

### Outlook

Singapore's economy will continue to experience some difficulty as the government moves the reverse previous policy errors and deal effectively with the current challenges facing the trade sector (the expected slowdown in US import growth, a relative decline in entrepot trade, increasing regional competition in high-tech and information industries, and withdrawal of GSP privileges) and the financial sector (increasing competition and regulatory difficulties). The actions currently being taken to deal with these problems (e.g., the willingness to reassess the entire economic diversification

CONFIDENTIAL

CONFIDENTIAL

strategy pursued since the late 1970s, the reversal of the government's high wage policy, and the changes in financial regulation) should place the economy, which remains basically sound, back on track. [redacted]

25X1

The popular pressures being felt in Singapore for a more open political system have had little effect on economic policymaking. Popular debate has centered on social and political rather than economic policies. Trade policy will likely remain the preserve of a fairly limited number of highly trained technocrats. In the long run, however, the increasing popular pressure for a more political policy process will probably lead to greater popular influence on policymaking -- even trade policymaking. However, the vital importance of trade in Singapore's economy makes it highly unlikely that this will lead to a major change in the main characteristics of trade policy. [redacted]

25X1

CONFIDENTIAL

CONFIDENTIAL

## Annex 6

South Korea

The perceived interrelationship among legitimacy, security, and economic development has been consistently used by successive South Korean leaders to justify the maintenance of authoritarian government. Authoritarian rule has reinforced the emphasis placed on hierarchy and deference in Korean governmental affairs, and resulted in a highly centralized, bureaucratic decisionmaking process that allows little extra-bureaucratic input. Trade policy is an especially important component of overall economic policy and has usually been made within the Blue House and a few government ministries, subject to limited popular influence.

25X1

Economic Policy

The South Korean economy has surprisingly few distortions, given the prevalence of selective and general government intervention and the drive to succeed whatever the obstacles. Imports are controlled more tightly than in Taiwan. Some sectors, including rice production, steel, motor vehicles and some types of machinery, are heavily protected. The government also intervenes to promote new industries and exports, not only by providing inducements, but also through direct allocations of credit, establishment of state enterprises, and political influence. A willingness to take risks characterized Korea's attempt to ride through the impact of the 1973 oil shock

CONFIDENTIAL

CONFIDENTIAL

by increasing bank borrowing rather than by cutting domestic expenditures.

While Korea has succeeded in sustaining rapid economic growth, with the exception of a sharp recession during 1980-81, it has also accumulated a large foreign debt and its inflation rate has been much higher than Taiwan's (nearly 20 percent a year). Korea has been among those countries that have suffered the largest negative external shocks since the early 1970s -- from export market slowdown, terms of trade declines, and high real interest rates. [redacted]

25X1

#### The Political System

South Korea is a bureaucratic-authoritarian state in which authority is based largely on official position and exercised according to bureaucratic norms and procedures, although personal factions and support networks are often critical in gaining office and holding it. There are limited democratic components, including an increasingly viable legislature, but the system remains fundamentally authoritarian. [redacted]

25X1

The military is the backbone of the South Korean ruling structure. Although military input into the administrative branch in terms of personnel and influence has been fairly limited under the Chun regime, the military's substantial representation in the Blue House and on Legislative Council staffs puts it in control of the government. The Democratic Justice Party (DJP), the legislative arm of the ruling coalition, is also controlled by the military.

[redacted] 25X1

For all of its capabilities in the field, the Korean military is not as professional an organization as it might first appear. The military chain of command is often disregarded and factionalism is rampant. Both of these characteristics result from the military's participation in politics. Its divisions together with its lack of a coherent political ideology probably

CONFIDENTIAL

CONFIDENTIAL

weaken the military's ability to hold on to power in the long-run.

25X1

Today the military is facing increasing opposition from important elements in Korean society, including the Church and university students. Widespread dissatisfaction with the political restraints imposed by the government has led to a new opposition political party -- the New Korea Democratic Party (NKDP) -- gaining significant representation in the Assembly. Liberalizing forces have had an important impact on the policy process.

25X1

### Policymaking

Korean political culture emphasizes hierarchy and deference to authority. Loyalty to the leader, consensus, and harmony are extolled. Reflecting these values, Korean leaders perceive their role to be one of active command rather than coalition building. Decisionmaking authority is therefore highly centralized. The President and his followers -- usually generals and higher civil servants -- constitute the ruling elite. They share responsibility for day-to-day decisionmaking, but the President is the final authority on all political matters, including trade policy.

25X1

Although there appears to be a slightly wider sharing of power among the various government organs under Chun Doo Hwan than was true under former President Park, the decisionmaking system has changed little. In fact, many of Chun's advisors are carryovers from the Park regime. The key ministries continue to exercise considerable latitude in the development and implementation of policy. As a result, despite the centralization of authority, there is considerable flexibility in policymaking.

25X1

The primary ministries responsible for trade formulation are the Ministry of Trade and Industry (MTI), the Ministry of Finance (MOF), the Economic

CONFIDENTIAL

CONFIDENTIAL

Planning Board (EPB), the recently established International Economic Planning Council (IEPC) associated with the EPB, and, ultimately, the Blue House and the President. As in other countries, however, various ministries get involved in trade policy when specific issues arise that are under their jurisdiction. [redacted]

25X1

In general, the Blue House both leads and pushes on economic policy. The most influential economic advisor at the Blue House is Sakong IL, who has been senior secretary for economics in the Presidnetial Secretariat since 1983. The American-educated Sakong is a skilled economist and technocrat with reformist policy views. The Blue House is reportedly committed to import liberalization and a revitalized market system. It is an objective that is not uniformly shared in the ministries or outside the government. [redacted]

25X1

Within the government there is a division between the different Ministries over trade policy. Typically, the EPB, the Ministry of Finance, and KDI, a government think tank tied to the EPB, argue in favor of more liberal trade policies. They are opposed by the Ministry of Trade and Industry (MTI) and KIET, a think-tank tied to MTI. [redacted]

25X1

The EPB is the dominant institution in economic policymaking in Korea. Headed by Deputy Prime Minister Kim Mahn Je, it coordinates economic policy throughout the government and chairs meetings at all administrative levels. The fact that the head of the EPB is always concurrently Deputy Prime Minister, together with the budgetary control the Board exercises over the ministries, has provided the Board with the necessary institutional power to carry out its wide-ranging responsibilities. [redacted]

25X1

The Ministry of Finance, currently headed by Chong In Yong, is responsible for both tax and monetary policies, as well as tariff policy. The Ministry's Monetary Board also controls the central bank. The Ministry of

CONFIDENTIAL

CONFIDENTIAL

Trade and Industry, headed by Kum Jin Ho, has responsibility for monitoring developments in most industrial sectors and overall Korean trade patterns. The Ministry also is principally responsible for managing quantitative trade restrictions. In general, MTI has opposed trade liberalization. [redacted]

Besides the ministries and their research institutes, political parties have recently assumed a role in trade policy formulation. The success of the NKDP in the recent elections has provided the opposition with a real voice. The NKDP has come out strongly against market liberalization and has strongly criticized US protectionism -- both popular issues in South Korea -- although it has no coherent economic policy. While it lacks the seats in the Assembly necessary to push through legislation, the NKDP has the authority to call up and question ministers on legislation. Economic issues are frequently the vehicle by which opposition groups voice dissatisfaction. The popular pressure created by the NKDP's stance on the liberalization issue has recently forced the DJP to reverse its stance and officially take a position against liberalization. [redacted]

25X1

Business groups also effect policy. The most important are the Korean Chamber of Commerce and Industry, the Federation of Korean Industries (FKI), and the Korean Traders Association (KTA). The FKI mainly serves large-scale businesses -- the chaebol. The President of the FKI is Hyundai chairman Chung Ju Yung. The leading chaebol include: Hyundai, Samsung (Lee Byung Chull) and Daewoo (Kim Woo Choong). Leaders of big business affect policy through personal ties to the political leadership and donations to the ruling party. Small businessmen depend upon the Korean Association of Small Business for representation. [redacted]

25X1

The procedures followed in short-term economic management and those involved in the formulation of longer-term policy are different. Short-term

25X1

CONFIDENTIAL

CONFIDENTIAL

policy formulation -- aggregate demand management, tax, exchange rate, and monetary policy -- is usually limited to a relatively small number of government officials. Long-term economic policymaking -- formulation of five-year plans -- involves many more participants. The main institution responsible for development planning in Korea is the Economic Planning Board (EPB). The Ministries, the DJP, and non-governmental institutions such as financial institutions, business associations, the press, major universities, and research institutes all are involved. [redacted]

25X1

Despite the formal consultation procedures employed in planning, the most serious weakness of the Korean economic policymaking process is the lack of true consensus-building procedures. Public debate and the number of participants in the process are kept to a minimum. Rapid decisions are, therefore, possible; but frequently the policy settled upon lacks much public support, which, at times, forces policymakers to reconsider policy. Although the Korean system is flexible enough to allow for the rapid reversal of policy decisions, frequent reversals can undermine economic and political stability. [redacted]

25X1

#### Trade Policy Implementation

In the early 1960s Korean industrialization strategy switched from one of import substitution to export-promotion. This transition occurred because: (1) rapid growth through easy import substitution of nondurable goods and their necessary intermediate goods had been exhausted; (2) the domestic market was too small to support the growth of the industries supported by import substitution especially with the large capital requirements necessary for such ventures; (3) the natural resource endowment was too poor to adopt a development strategy based on use of domestic resources; (4) there was a

CONFIDENTIAL

CONFIDENTIAL

shortage of foreign exchange due primarily to a reduction in US foreign aid; and (5) Korea's low-wage, well-motivated, and well-educated labor force provided a comparative advantage in the production of labor-intensive goods for export; and (6) the political leadership under Park Chung Hee was determined to attain a high rate of growth. [redacted]

25X1

Despite the policy shift, imports remained heavily controlled by the government and tightly restricted from 1968 to 1982. Manufactured goods and consumer goods were most protected. The method of controlling imports changed over time. Non-tariff barriers grew in significance relative to tariffs, and by 1982 they were the most important method of restriction. The Chun regime is now making a serious effort to liberalize imports to strengthen competitiveness. The current economic plan, 1982-1986, calls for less direct government intervention and more reliance on market forces. However, Koreans are resisting liberalization and progress in this direction will probably be slow. [redacted]

25X1

### Outlook

There are strong and growing pressures on the Korean government to more fully democratize the political system and popular demands for constitutional reform have reached new levels. In this environment it is unlikely that economic policy can be fully sheltered from popular pressures. Already import liberalization has become a major political issue, despite having support from the Blue House. In this new policy environment, presidential support no longer guarantees success for a particular policy. Policymakers will have to pay greater attention to building a consensus for their policy initiatives prior to their announcement of them. [redacted]

25X1

In a more open system, popular resistance to imports, created by years of

CONFIDENTIAL

CONFIDENTIAL

government propaganda, will probably make trade liberalization more difficult. Already, popular pressure has aggravated differences between the EPB/MDR technocrats and those in the MTI. Due to these tensions, the International Economic Policy Council, which handled trade negotiations and favored relatively rapid liberalization, has been dissolved. [redacted]

25X1

South Korean economic progress will still depend on vigorous export growth, and policy makers will continue to emphasize international economic cooperation. Seoul will also probably continue to use bilateral negotiations with the United States to capitalize on what they view as a special relationship between the two countries. Consequently, the outlook for limited and gradual trade liberalization remains good. However, public efforts to pressure Korea into trade liberalization could lead to further attacks on pro-liberalization elements in the government. [redacted]

25X1

CONFIDENTIAL

CONFIDENTIAL

## Annex 7

Taiwan

Because Taiwan is not politically recognized by many nations, economic success has been a cornerstone of the regime's legitimacy. At home the government can point to the differences in living standards between Taiwan and the mainland. Abroad, even with little recognition, Taiwan's economic strength makes commercial relations with Taiwan desirable for most countries. Because of the importance of economic success, economic and trade policy are dealt with at the highest levels.

25X1

Economic Policy

Taiwan shares Singapore and Malaysia's conservative approach to fiscal and monetary policy. The government is extremely sensitive to inflation, partly because it considers runaway inflation on the mainland in the 1940s to have been a major cause of the communist victory. Its inflation rate is generally near or below global inflation. Taiwan has adjusted very fast to external shocks -- for example, by tightening monetary policy in reaction to both oil shocks, GDP and real wages fell sharply but briefly, a dangerous accumulation of external debt was avoided, and the economy soon resumed a strong upward trend. While avoiding major distortions and following conservative monetary and fiscal policies, Taiwan tightly regulates imports to avoid disruptive effects on domestic producers and to nurture promising infant industries. It also actively promotes exports.

25X1

CONFIDENTIAL

The Political System

Although Taiwan's economy has developed rapidly since 1949, political change has been much slower. For over fifty years Chiang Kai-shek or his son, Chiang Ching-kuo, have dominated Nationalist politics through the Kuomintang (KMT), Taiwan's dominant political party. The political climate under both Chiangs has been predictable and constant, contributing significantly to the growth process. [redacted]

25X1

The KMT thoroughly dominates Taiwan's political life. All important government posts must be filled by men who, if not party members themselves, are amenable to the party leadership. It is certain that whoever he is, Chiang's successor will be a long-time and successful party loyalist. [redacted]

25X1

Taiwan's political system has many rigidities and impediments to change. This is largely due to three mutually supporting factors: predominance of the KMT, cronyism within the KMT old guard, and the long tenures of KMT officials in the bureaucracy. Any moves towards liberalization or devolution of authority will certainly come in small and slow steps. [redacted]

25X1

However, there is recognizable, if modest, opposition to KMT dominance and system rigidities. An increasing number of native Taiwanese are slowly gaining influence in the party and the government. This trend has been met with considerable resistance from established KMT leaders, and, in reality, relatively few native Taiwanese hold top posts in either the party or the government. Many of the KMT old guard fear that the younger Taiwanese politicians would take a more pragmatic position on the issue of improving relations -- or at least economic relations -- with the PRC. Some of the biggest native Taiwanese gains have come through Legislative Yuan elections.

[redacted]

25X1

Policymaking

Nearly all trade policy questions are determined within the Executive Yuan (branch). While the Legislative Yuan can voice approval or opposition to Executive Yuan decisions, it has little authority and acts only as a rubber stamp for legislation, all of which is drafted by the executive branch or senior KMT officials. [redacted]

25X1

The policymaking process is authoritarian -- run by the president, part of his cabinet, and a few KMT old guard cronies. However, while policymaking is still relatively centralized, it has become increasingly complex, with inputs from an increasing number and variety of interests and groups. Most of this decentralization is intragovernmental -- extragovernmental interests remain largely excluded from active participation, although in economic and trade matters the various ministries have increasingly sought advice from the private sector during policy formulation. [redacted]

25X1

Decentralization pressures have had the greatest influence in the economic policy area. Intragovernmental participation has extended to technocrats and bureaucrats well below ministerial level in the main economic ministries (Finance, Economic Affairs, and the Council for Economic Planning and Development). Despite these trends, economic policymaking in Taiwan is still relatively centralized among a handful of top-level bureaucrats. Among these men, there is broad agreement on the direction that Taiwan's economy should take. Essentially this is towards a more liberalized, privatized, and higher-technology economy. Although there may be significant disagreement over more detailed aspects of policy, these debates are not aired in public. It should also be noted that top officials in Taiwan have broad governmental experience, a result of frequent lateral shifts from one ministry or council

to another. Many also share similar educational backgrounds. These and other commonalities contribute to what appears to be an uncommon amount of camaraderie and professional cooperation among Taiwan's top officials. [redacted]

The major actors that shape Taiwanese trade policy include President Chaing Ching-kuo and senior KMT officials. The Executive Yuan, headed by Premier Yu Kuo-kwa, who heads the Executive Yuan, is closely allied with the old guard on economic policy, and has a go-slow attitude towards liberalization. The Finance Ministry (MOF), and Finance Minister Chien Chun, are viewed as supportive of economic and trade liberalization. The Ministry of Economic Affairs (MOEA), headed by Lee Ta-hai, is more protectionist than the MOF. The Board of Foreign Trade, headed by Vincent Siew, often serves as the spokesman for the Executive Yuan on trade policy, while the Industrial Development Bureau, headed by H.S. Yu, is viewed as more protectionist than the Board of Foreign Trade. Also involved in trade policy are members of the Standing Committee of the KMT and a few Ministers without portfolio who have particular interests in trade policies. The Council for Economic Planning and Development has, under Chao Yao-ting, become a more active player, and has tended to support more rapid liberalization. There are also a number of private businessmen both Chinese and foreign who, because of the relative importance of their businesses to Taiwan's economy, often have input on trade matters. [redacted]

25X1

25X1

#### Trade Policy Implementation

Taiwan's government operates as a classic Chinese bureaucracy, which relies on technocrats only in policy-specific areas. Technocrats are slowly being promoted to senior bureaucratic positions, and this is gradually changing the character of bureaucratic decisionmaking, especially in economic

and trade areas. However, the decisionmaking system remains quite opaque.

[redacted]

25X1

The government has a large role in economic activity. Reflecting the personalistic element of Taiwan's policymaking style, decisionmaking in the bureaucracy has a large discretionary element. Laws and regulations are written so generally that considerable administrative discretion is possible. However, discretion is usually exercised at fairly high levels within ministries.

[redacted]

25X1

In contrast to South Korea, Taiwan tends to use incentives rather than direct controls to guide behavior. There is less direct intervention or promotion of specific projects than in South Korea. However, economic plans are an important integrating element for broadly guiding policy and constructing incentive programs.

[redacted]

25X1

Trade policy in Taiwan has been a function of broader economic goals and is usually linked with specific industrial policies. It was not until Taiwan's economy began to meet basic domestic market needs, and the inflation rate and the balance-of-payments were brought under control, that Taiwan moved away from import substitution policies and embarked on the aggressive export promotion strategy that continues to characterize its foreign trade policy. Today, while import barriers remain substantial, they are generally less restrictive than in South Korea.

[redacted]

25X1

In the 1960's Taiwan began to aggressively promote exports. Actions included the establishment of export processing zones and offering low interest loans for exporters. Trade policy initiatives also included the targeting of major industries, such as automobiles, for intensified growth. Targeting entails a wide variety of policy instruments, including easy access to low interest credit and tax rebates on imported inputs.

[redacted]

25X1

CONFIDENTIAL

Like many other LDCs, Taiwan has been subjected to growing restrictions on some of its principal exports, notably textiles. It is unlikely, however, that those restrictions have done much damage to Taiwan's economy. Taiwan was able to upgrade its textile exports, raising their value for a given quantitative limit. More important, Taiwan began, before other LDCs, to diversify away from textiles, into consumer electronics and other unrestricted product areas. [redacted]

25X1

Outlook

The KMT remains strongly in control, but the succession is a concern. Nevertheless, it is unlikely that the KMT will lose its firm grip. However, its control could become more diffuse without the strong leadership and prestige of Chiang. This could lead to further decentralization of power and policymaking. Over the next five years, even allowing for considerable gains by non-KMT politicians, the Legislative Yuan will probably continue to lack the authority to play a real role in policymaking. The Legislative Yuan, however, is increasingly making its views felt through public discussion and debate. The Executive Yuan is being forced to at least listen and respond to a more diverse set of ideas and interests. [redacted]

25X1

Technocratic influence over policymaking will continue to increase. Technocrats are a constituency for liberalization, while their preference for incentives over controls makes them susceptible to market-based economic arguments. However, a widespread consensus among policymakers and the public on trade policy assures little change. Trade policy will continue to follow an irregular but persistent course of liberalization. [redacted]

25X1

25X6

CONFIDENTIAL

**Page Denied**

**SUBJECT: Trade Policy Formulation in Selected Developing Countries:  
Underlying Influences**

25X1

OGI/BCD/T/

14 July 86/

25X1

**Distribution:**

1 - Joseph Dannin, Commerce  
1 - H.P. Goldfield, Commerce  
1 - Henry Misisco, Commerce  
1 - Peter Field, Commerce  
1 - Roger Severance, Commerce  
1 - Eric Melby, State  
1 - Ann Hollick, State  
1 - William Barreda, Treasury  
1 - Michael Driggs, White House  
1 - Stephen Danzansky, NSC  
1 - Geza Feketekuty, USTR  
1 - Jon Rosenbaum, USTR  
1 - Peter Allgeier, USTR  
1 - Harvey Bale, USTR  
1 - SA/DDCI  
1 - ExDir  
1 - DDI  
1 - DDI/PES  
1 - NIO/BOON  
1 - DD/OGI, D/OGI  
1 - CPAS/ISS  
6 - CPAS/IMC/CB  
1 - OGI/Ph/Ch  
8 - OGI/EXS/PG  
1 - C/BCD  
1 - C/BCD/T  
3 - BCD/T

**CONFIDENTIAL**